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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1960.

No. [redacted] 87

MANAGED FUNDS, INCORPORATED,
Petitioner,

vs.

J. JOHN BROUK et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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INDEX.

Page

Opinions Below 1

Jurisdiction 1

Questions Presented 2

Statute and Rule Involved 3

Statement 4

The Complaints 6

1. The Parties 6

2. Resume of Facts Alleged in the Complaints ... 7

A. The Fund's unlawful investment advisers and the parties responsible for payment made to said advisers 7

B. The Fund's deviation from its stated investment policy and the parties responsible therefor 9

Reasons Relied on for the Allowance of the Writ 12

1. The Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court 13

A. The Investment Company Act of 1940 does impose duties on directors, and they are subject to liability to the Fund for breach of such duties or for their causing a violation of the Act to the damage of the Fund. The District Court, therefore, had jurisdiction under Section 44 of the Act 13

1. Section 15 (c) of the statute makes it *ultra vires* and illegal to "renew or perform" any advisory contract, oral or written, without approval of the contract by a majority of the "unaffiliated" directors 16

2. Section 15 (a) makes it illegal under any circumstances to initially employ an adviser unless such contract is initially approved by shareholders 18

3. The Directors have a duty to require adherence by the Fund to its stated policy and not participate in causing a deviation from such policy 19

B. Legislative Intent. The Complaints allege breaches of these duties by respondents to the damage of the Fund 22

II. The decision which the Court of Appeals has rendered is in conflict with the Court of Appeals for the Second Circuit on the same matter, namely, construction of parallel sections of the Public Utility Holding Company Act and the Investment Company Act of 1940 25

Conclusion 26

Appendices—

A. Opinion of the Court of Appeals 29

B. Judgment of the Court of Appeals 65

C. Statute and Rule 67

Sections of the Investment Company Act of 1940

1 (b) (1), (2), (4) and (6) 67

8 (b) (2) 70

9 (a) 68

10 (a) 68

13 (a) (3) 70

15 (a) and (c) 69

44 71

47 (b) 72

Rule 8 (a) of the Federal Rules of Civil Procedure 72

Statutes and Rule.

Investment Company Act of 1940, Section 80a et seq., of Title 15, U. S. C.:
Section 1 (b), 80a-1 (b) 3, 11, 20, 21
Section 8 (b) (1) (2), 80a-8 (b) (1) (2) 3, 9, 10, 19
Section 9, 80a-9 21
Section 10, 80a-10 21
Section 13 (a) (3), 80a-13 (a) (3) 4, 10, 19
Section 15, 80a-15 ..... 7, 8, 9, 16, 17, 18, 22, 24
Section 17 (h), 80a-17 (h) 21
Section 30 (f), 80a-29 (f) 20
Section 36, 80a-35 21
Section 44, 80a-43 ..... 2, 3, 4, 5, 13, 22
Section 47, 80a-46 ..... 4, 9, 15, 16, 19, 26
Public Utility Holding Company Act of 1935, Section 79 et seq. of Title 15, U. S. C.:
Section 79z (b) 14, 26
Rule 8 (a), Federal Rules of Civil Procedure 3, 4, 23
Section 1292 (b), Title 28, U. S. C. 3
Securities Act of 1933, Section 77 et seq. of Title 15, U. S. C. 14
Securities and Exchange Act of 1934, Section 78 et seq. of Title 15, U. S. C.:
Section 78cc (b) 14, 26
Section 78p (b) 20
Trust Indenture Act of 1939, Section 78 et seq. of Title 15, U. S. C. 14

AUTHORITIES CITED.

Cases:

Alleghany Corp. v. Breswick & Co., 353 U. S. 151 (1957) 16

Baird v. Franklin, 141 F. 2d 238 (2d Cir., 1944) 14
Bell v. Hood, 327 U. S. 678 (1945) 22

Birnbaum v. Newport Steel Corporation, 193 F. 2d 461 (2d Cir., 1951) 20
Breswick & Co. v. Briggs, 135 F. Supp. 397 (1955) ... 16
Breswick & Co. v. United States, 134 F. Supp. 132, 138 (S. D. N. Y., 1955) 16
Breswick & Co. v. United States, 138 F. Supp. 123, 131 (1955) 16
Brown v. Bullock, C. C. H. Federal Securities Law Reporter, Current, Par. 91,013 (S. D. N. Y., 1961) 16, 17, 21
Cogan v. Johnston, 162 F. Supp. 907 (S. D. N. Y., 1958) 16
Conley v. Gibson, 355 U. S. 41, 45, 46 (1957) 23
Dann v. Studebaker-Packard Corporation, Par. 91,002, C. C. H. Federal Securities Law Reporter, Current (6th Cir., 2/6/61) 14
Downing v. Howard, 162 F. 2d 654 (3d Cir., 1947) 20
Errion v. Connell, 236 F. 2d 447 (9th Cir., 1956) 14
Fischman v. Raytheon Mfg. Co., 188 F. 2d 783 (2d Cir., 1951) 14
Fratt v. Robinson, 203 F. 2d 627 (9th Cir., 1953) 14
Goldstein v. Groesbeck, 142 F. 2d 422 (2d Cir., 1944) 14, 25, 26
Hooper v. Mountain States Securities Corp., 282 F. 2d 195 (5th Cir., 1960) c. d., October Term 1960 14
Howard v. Furst, 238 F. 2d 790 (2d Cir., 1956) 20
Hurn v. Oursler, 289 U. S. 238 (1933) 5
In Re Managed Funds, CCH Fed. Sec. Law Rep., Current, Par. 76,662 (1959) 4
Jung v. K & D Mining Co., 260 F. 2d 607 (7th Cir., 1958) 14, 23
Matheson v. Ambrust, 284 F. 2d 670 (9th Cir., 1960), c. d., October Term 1960 14

Schwartz v. Bowman, 156 F. Supp. 561 (S. D. N. Y., 1957) 13
Slavin v. Germantown Fire Ins. Co., 174 F. 2d 799 (3d Cir., 1949) 14
Taussig v. Wellington Fund, Inc., 187 F. Supp. 179, 197 (U. S. D. Ct., Del., 1960) 12
Texas & P. R. Co. v. Rigsby, 241 U. S. 33, 40 (1916) ... 14
Textile Workers Union v. Lincoln Mills, 353 U. S. 448 (1957) 27
The Fair v. Kohler Die & Specialty Co., 228 U. S. 22 (1913) 22

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J. JOHN BROUK et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitled case on January 13, 1961.

OPINIONS BELOW.

The District Court overruled motions of certain defendants to dismiss the complaint. It did not file an opinion. The opinion of the Court of Appeals reversing the order of the District Court (App., *infra*, p. 29) is reported at 286 F. 2d 901.

JURISDICTION.

The judgment of the Court of Appeals (App., *infra*, p. 65) was entered on January 13, 1961. On February 1, 1961, petitioner filed in the Court of Appeals a petition

for rehearing or, in the alternative, for transfer to and consideration by the Court en banc. On February 6, 1961, motion of the Securities and Exchange Commission for leave to participate amicus curiae was filed. The petition for rehearing and the motion of the Securities and Exchange Commission were denied on March 6, 1961.

The jurisdiction of this Court rests on 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED.

Petitioner, a mutual fund (registered as an investment company under the Investment Company Act of 1940*), sued its former investment advisers, sales companies, directors, and brokers in the United States District Court, for alleged violations of and breaches of duty created by the Investment Company Act of 1940, resting jurisdiction upon Section 44 of the Act giving the district courts jurisdiction of all causes of action to enforce any liability or duty created by the Act.

Respondents, who were certain of the defendant directors, moved to dismiss the action on the ground that there was no jurisdiction over the subject matter** for the assigned reason that there were no duties of directors created by the Investment Company Act of 1940, and hence no remedy against them cognizable in the Federal District

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* The Investment Company Act of 1940 is set forth in Section 80a-1 et seq. of Title 15, U. S. C. The section numbers of 80a correspond to the section numbers of the Act until 80a-29, which is Sec. 30 of the Act, and from there on the corresponding section numbers of the Act are one digit above the section numbers set forth in 80a.

** Certain of the respondents, who were non-residents, also asserted that there was no jurisdiction over their respective persons, since they were served with process by extra-territorial service as authorized by Section 44 of the Investment Company Act of 1940. The District Court ruled against respondents on this phase of the motion. The Court of Appeals did not pass on this issue.

Court. These motions were denied by the District Court, and respondents appealed this order under the new interlocutory appeal section, Section 1292 (b), Title 28, U. S. C. The Court of Appeals reversed and remanded, directing dismissal of said respondents.

1. The first question presented is whether the Investment Company Act of 1940 imposes duties on the directors the breach of which gives rise to a civil cause of action by a fund against them in the District Court of the United States, under Section 44 of the Act.

2. If so, does petitioner's complaint, which avers that these respondent directors knowingly participated in violations of the Act and breached their own statutory duties created by the Act, state a claim against them within the broad liberality afforded a pleader under Rule 8 (a) of the Federal Rules of Civil Procedure?

STATUTE AND RULE INVOLVED.

The statute involved is the Investment Company Act of 1940, regulating the internal affairs and the investment advisory contracts of mutual funds,—more particularly, the following sections: Section 1 (b) declaring that the evils at which the Act is directed include "inside" operation by directors who are self-interested advisors, or by salesmen or underwriters having conflicts of interest, and to prevent operation of such funds for the profit of such insiders rather than for the investors; Sections 9 and 10 regulating the composition of boards of directors so as to limit the number of self-interested (affiliated) advisers and brokers or underwriters who may serve on such boards; Section 15 requiring initial approval of self-dealing contracts of advisers and underwriters by shareholders, and the extension thereof by shareholders or by disinterested (unaffiliated) directors; Section 8, (b) (2) requiring the management to declare the fund's fundamental policies for information

of investors, and Section 13 (a) (3) making deviation from such declared policies illegal.

Section 47 (b) declares that contracts made in violation of the statutory procedure are void, not merely voidable as in the case of "insiders" contracts at common law.

The jurisdictional section of the Act, Section 44, gives concurrent jurisdiction to State and Federal courts to enforce any liability for breach of duty created by the Act.

Rule 8 (a) of the Federal Rules of Civil Procedure is involved in the construction of petitioner's complaint.

These sections of the Act and the said rule are set forth in full in the Appendix, *infra*, beginning p. 67.

STATEMENT.

The District Court denied motions to dismiss the complaints in two actions, and these orders were reversed by the Court of Appeals on the grounds that there were no statutory duties of directors under the Investment Company Act of 1940 nor any legislative intent in enacting said statute to impose statutory duties upon directors, no remedy for breach, and that the complaints, which alleged a knowing participation by directors in violations of the Act, only asserted "insurers" liability.

These suits were filed after public disclosures in "Stop-order Proceedings" before the Securities and Exchange Commission in May of 1959.*

* The Commission, on July 31, 1959, entered an order prohibiting Fund from selling its stock, *In Re Managed Funds*, C. C. H. Fed. Sec. Law Rep., Current Par., 76,062 (1959), for the reason, inter alia, that the Fund was operating with an unlawful investment adviser. The S. E. C. made this finding regarding respondents (pp. 80, 509):

> "On the basis of the record it is evident that the directors failed to discharge their duties and responsibilities as directors, and failed to perform the functions which the prospectus represented they were performing."

The first suit was a derivative stockholders' suit instituted in the District Court in Delaware by Emanuel Josephson on behalf of Managed Funds, Incorporated, hereinafter sometimes referred to as the "Fund." The second suit was instituted by the Fund in the Eastern District of Missouri. The Josephson suit was thereafter transferred to the District Court for the Eastern District of Missouri and the causes consolidated.

Both suits were against the Fund's former investment advisers, sales companies, directors and brokers. The complaints sought to recover (1) unearned advisory fees in excess of $1,000,000 paid to the Fund's disclosed adviser, (2) brokerage commissions in excess of $1,500,000 paid to the Fund's undisclosed and unapproved adviser, for investment advice illegally rendered, and for brokerage transactions which were contrary to the Fund's stated and fundamental investment policy, and (3) the Fund's damage in making said payments and for losses resulting from excessive brokerage transactions. The accountability for the said monies paid and the damages incurred were based upon alleged violations of the Investment Company Act of 1940, and for breaches of statutory duty imposed thereby.*

Jurisdiction was based on Section 44 of the Investment Company Act of 1940 (80a-43 of Title 15, U. S. C.), which provides that the "district courts . . . shall have jurisdiction of violations" of the Act, and of "all suits in equity and actions at law brought to enforce any liability or duty created by, or enjoin any violation of" the Act.

The facts are set forth in the complaints and are confessed by respondents' motions.

* The Fund's complaint contains three other counts. Count II asserts liability for losses under the Securities Act of 1933; Count III raises liability for breaches of fiduciary duties, and Count IV seeks recovery on the claim of a conspiracy. Such counts may be joined with Petitioner's statutory claim. *Hurn v. Oursler*, 289 U. S. 238 (1933).

THE COMPLAINTS.

1. **The Parties.** The following is a list of the defendants:

Individual Slaytons (Hilton & Hovey)	Officers and directors of the Fund who also controlled or owned the Slayton Companies (R. 2).
Slayton Companies[**] Slayton & Co., and Mutual	"Underwriters" which sold the Fund's shares to the public, controlled by the Slaytons.
Slayton Associates	The Fund's designated investment adviser, owned by the Slaytons.
Directors (including Respondents)	Twelve former directors other than Slaytons, referred to in Fund's complaint as "outside directors."
Model, Roland & Stone	A partnership of 11 New York brokers.
Jaquith	Associated with brokers as investment adviser (R. 14).
Smith	Brother-in-law of defendant Hovey Slayton and employee of brokers (R. 3).
Stubbs	Former director of Fund and employee of brokers (R. 3).

** Slayton Associates, Inc., is hereinafter referred to as "Slayton Associates"; Slayton & Company, Inc., and Mutual Fund Distributors, Inc., are hereinafter referred to as "Slayton Sales Companies."

2. **Resumé of Facts Alleged in the Complaints.**

A. The Fund's unlawful investment advisers and the parties responsible for payments made to said advisers.

(1) Commencing August 15, 1952, and continuing until April, 1959, the Slaytons' advisory corporation, Slayton Associates, was awarded successive written contracts to act as the Fund's disclosed investment adviser (R. 4, 14).

This initial advisory contract was approved by the Fund's stockholders as required by Section 15 (a) of the Act. This written contract was, after August 15, 1954, extended each year throughout the period (R. 14) by defendant directors, including respondents. Under Section 15 (c) of the Act such contract could only be extended by a majority of the "unaffiliated directors."

Such advisory contract provided that Slayton Associates would render advisory, research and statistical services with reference to investments as were in accordance with Managed Fund's policies. Slayton Associates was paid by the Fund an annual fee in the amount of one-half of 1% of the Fund's asset value (R. 4), and said payments over the period totaled in excess of $1,000,000 (R. 15). This August 15, 1952, contract, effective throughout the period, provided that it was not assignable (R. 15) as required by the Act, Section 15 (a) (4).

(2) Commencing on December 1, 1953, and continuing until April, 1959, defendant Jaquith (the defendant brokers' investment adviser) assumed the duties of Slayton Associates, the above mentioned designated investment adviser for Managed Funds (R. 15). Slayton Associates, while still receiving the fee from the Fund, as set forth above, for purporting to perform advisory services, unlawfully delegated its duties to Jaquith and the defendant brokers (R. 16). This assignment violated the contract and rendered the service illegal.

(3) This assignment and transfer to defendant Jaquith of the advisory functions took the form of a ten-year contract, dated December 1, 1953, wherein defendant Jaquith was to use his best judgment in the selection, purchase and sale of securities for the Fund and was to be compensated in the form of minimum brokerage commissions with respect to the Fund's portfolio transactions directed to Jaquith's firm, the defendant brokers (R. 4, 5, 15).

(4) Neither the said contract of December 1, 1953, between Slayton Associates and Jaquith, nor Jaquith's assumption of the investment advisory function for Slayton Associates thereafter, was ever approved by the stockholders of Managed Funds (R. 7, 16), as required by Section 15 of the Act.

(5) Notwithstanding the assumption of the advisory function by the defendant brokers and the failure to have this relationship approved by the stockholders, the Slaytons and the directors, including the respondents, caused or permitted (R. 6, 19) the Fund to pay Slayton Associates in excess of $1,000,000 during the period for services that Slayton Associates did not perform (R. 16).

(6) During this same period, the same defendants caused the Fund to pay the defendant brokers and Jaquith in excess of $1,500,000 in brokerage commissions in payment for investment advice (R. 5).

(7) The complaints allege that such conduct was in violation of the Investment Company Act of 1940, since Slayton Associates unlawfully abdicated its function and defendants Jaquith and the brokers served and acted as investment advisers, without a written contract approved by the stockholders (R. 7). Section 80a-15 (a) provides that it is illegal to act as an investment adviser unless a written contract is approved by the stockholders of the fund. Subsection 15 (a) (4) requires automatic termina-

tion of stockholder-approved advisory contract upon its assignment. Aiding the remedy, both illegal contracts were expressly declared "void" under Section 47 (b), 80a-46 (b).

(8) Petitioner claimed it was a breach of the directors' duties under the Act [15 (c)] to approve a contract, and make payments thereunder, when the contract, by the provisions of the Act, had been terminated [15 (a) (4)] and was void [47 (b)]. It was a further breach of the directors' duties, under 15 (a) and (c) to operate, and to pay out money to the defendant brokers, under the unapproved and second illegal and void contract! Not only was it alleged that respondents did this, but it is alleged that they did it "knowingly" (R. 6, 19).

B. The Fund's deviation from its stated investment policy and parties responsible therefor.

(1) In accordance with the Investment Company Act, Section 8 (b) (2), the announced policy of Managed Funds, as set forth in its registration statements and prospectuses, was to provide for "capital growth", and to the extent consistent with such policy, to seek reasonable income on its investments, which net investment income and any realized profits on the sale of securities in its portfolio would be distributed quarterly (R. 4).

(2) After the defendant Jaquith and the broker defendants usurped the advisory function, the Fund's basic policy of "capital growth" was not followed (R. 5). Rather, a policy was followed in handling the Fund's portfolio so as to maintain a predetermined amount of distributions, and if income from portfolio investment was insufficient, to realize capital gains from the sale of the Fund's portfolio securities to pay these distributions (R. 5, 6).

(3) This policy, which respondents followed at the direction of the insiders (R. 6, 19), was a deviation from the stated policy of capital growth in that the Fund's portfolio securities were "churned", so that in 1958, as an instance, the rate of turnover of the portfolio securities was 98% as compared with 20% average in the trade (R. 16). This was likewise done without stockholder approval (R. 17).

(4) The policy which was followed resulted in gross mismanagement of and loss and damage to the Fund's portfolio (R. 6), in that the securities which had appreciated and had promise of more growth, were sold off and often immediately repurchased, whereas stocks which had unrealized depreciation were left in the portfolio. The portfolio was churned to realize capital gains so as to keep up an appearance of high "dividends", a sales feature exploited by the Slayton Sales Companies, who profited (R. 6).

(5) The policy of high turnover of the Fund's portfolio securities, resulted in a direct benefit to the defendant brokers and Jaquith (R. 6) who, as above stated, were also doubling as investment advisers and were being compensated in the form of brokerage commissions paid by the Fund on portfolio transactions (R. 5). The $1,500,000 paid said brokers was sufficient to enable them to pay, at the direction of the Slayton defendants, the defendant Smith, Hovey Slayton's brother-in-law, and the defendant Stubbs, the Slaytons' former business associate and former director of the Fund, in excess of $50,000 per year each, in commissions, when said defendant recipients did not perform any services in return for such payments (R. 5).

(6) Section 13 (a) (3) makes it unlawful to deviate from a fund's fundamental policy, stated under 8 (b) (2),

unless authorized by a majority of the fund's outstanding securities. The Managed Funds complaint alleged that the policy followed was thus illegal as being contrary to the Fund's stated policy (R. 7). Further, it is contrary to the policy of the Act, Section 1 (b) (2), for a fund to be operated, managed, and its portfolio securities selected, in the interest of directors, officers, investment advisers, brokers and dealers, rather than in the interest of all classes of security holders (R. 6).

(7) Petitioner claimed respondent directors had a duty under the Act not to permit and certainly not to participate in causing a deviation from fundamental policy, and that they were jointly liable for this violation and breach of statutory duty; the directors are in charge of the Fund's investment policy; the capital gains which were realized pursuant to the policy actually followed were distributed to stockholders by these respondent directors, who declared dividends; the distribution of these capital gains by respondents was part and parcel of the unlawful policy. These respondents knowingly participated, aided and abetted a plan whereby petitioner was operated in the interest of insiders rather than in the interest of the stockholders (R. 6, 19).

3. **Relief Sought.** The complaints sought not only an accounting for profits from those defendants who profited, but also sought damages from all defendants jointly liable, whose acts proximately caused damage to the Fund.

As above stated, the Court of Appeals reversed an order of the District Court overruling motions to dismiss.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The case presents a question never before decided by this Court, namely whether there is a private right of action against directors for breach of any duty imposed upon them under the Investment Company Act of 1940.

This Federal statute regulates the internal affairs of mutual funds. It sets forth requirements as to the make-up of the boards of directors of such trusts and even provides a mandatory procedure to be followed in the execution and performance of insider contracts—the heart of this case. Yet, the Court of Appeals has ruled that directors, managers of a fourteen-billion dollar industry,* are not subject to liability under this Act.

The issue of director responsibility under this Act is a matter of grave public importance. The stock of these funds is being sold to persons all over the country. The stockholders are often small investors who seek the expertise of the management of these funds, and this is one of the inducements for such investment.

The Investment Company Act was passed to regulate certain inside dealings to which these trust funds were peculiarly susceptible. The responsibility of directors who are the shareholders' delegates—elected and given specific responsibility under the Act to control the self-interest of insiders dealing with the fund, is all-important.

This case brings up for decision the responsibility of directors for their knowing participation in violations of the Act and in permitting, aiding and abetting flagrant abuses by insiders and brokers of the Fund. More par-

* *Tanssig v. Wellington Fund, Inc.*, 187 F. Supp. 179, 197 (U. S. D. Ct., Del., 1960).

ticularly, petitioner submits that there are statutory duties imposed on directors to harness the basic conflicts of interest the law was designed to regulate, namely, self-dealing advisory contracts. Contrary to the ruling of the Court of Appeals, these duties are both expressed in the Act and implied from the manifest legislative intent in enacting the law.

Petitioner does not claim that these respondents are liable as "insurers", as the Court of Appeals seemed to construe the complaints. Nor does the Fund assert "vicarious liability" against respondents for the acts of others or for the Fund's own illegality. Petitioner's claim against respondents is based upon their own affirmative acts and omissions in violation of their own statutory duties, which acts and omissions aided and abetted the more active tortfeasors.

1. The Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court.

The Court of Appeals, in reversing the Trial Judge, has erroneously ruled (1) that the Act does not subject directors to liability, and (2) that the complaints aver only "insurers'" liability.

A. The Investment Company Act of 1940 does impose duties on directors, and they are subject to liability to the Fund for breach of such duties or for their causing a violation of the Act to the damage of the Fund. The District Court, therefore, had jurisdiction under Section 44 of the Act.

While this Court has not expressly ruled on the issue, the lower Federal Courts have held that there is a private right of action to persons damaged by violation of pro-

visions of the Securities Acts* even though a remedy or a right of action is not specifically given for the section violated.**

This is the doctrine of implying a remedy for violation of a statute. The cases have relied upon the decision of this Court in **Texas & P. R. Co. v. Rigsby**, 241 U. S. 33, 40 (1916), wherein the "inference of a private right of action" for violation of a Federal Statute was upheld to support Federal jurisdiction on the application of the maxim "*Ubi jus ibi remedium*".

The case of **Goldstein v. Groesbeck**, 142 F. 2d 422 (2d Cir., 1944), dealt with directors' liability (Electric Bond and Share) for violation of duty with respect to analogous sections of the Public Utility Holding Company Act. The court there held directors liable in a suit on behalf of their subsidiary corporation for amounts paid out under unregistered and, hence (by that Act), unlawful and void service contracts. That court, in ruling that the plaintiff stated a claim, said, on pages 425, 426:

> "Section 25, 15 U. S. C. A., § 79 y (identical to 80a-43), provides that 'any suit or action to enforce

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* Securities Act of 1933 and Trust Indenture Act of 1939 (Section 77 et seq. of Title 15, U. S. C.); Securities and Exchange Act of 1934 (Section 78 et seq. of Title 15, U. S. C. A.); Public Utility Holding Company Act of 1935 (Section 79 et seq. of Title 15, U. S. C.); and the Investment Company Act of 1940.

** Cases in the Second Circuit, *Baird v. Franklin*, 141 F. 2d 238 (2d Cir., 1944), *Goldstein v. Groesbeck*, 142 F. 2d 422 (2d Cir., 1944), and *Fischman v. Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir., 1951); the Third Circuit, *Slavin v. Germantown Fire Ins. Co.*, 174 F. 2d 799 (3d Cir., 1949); the Seventh Circuit, *Jung v. K & D Mining Co.*, 260 F. 2d 607 (7th Cir., 1958); the Ninth Circuit, *Pratt v. Robinson*, 203 F. 2d 627 (9th Cir., 1953), and *Errion v. Connell*, 236 F. 2d 447 (9th Cir., 1956); *Matheson v. Armbrust*, 284 F. 2d 670 (9th Cir., 1960); and recently by the Fifth Circuit, *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (5th Cir., 1960), c. d., October Term, 1960; and, more recently (since the instant decision), by the Sixth Circuit, *Dann v. Studebaker-Packard Corporation*, Par. 91,002, C. C. H. Federal Securities Law Reporter, Current (6th Cir., 2/6/61).

any liability or duty created by' the Act may be brought 'in the district wherein any act or transaction constituting the violation occurred' or 'in the district wherein the defendant is an inhabitant or transacts business.' The present action is surely to enforce a duty created by the Act, since but for the Act the payments under the service and construction contracts would be innocuous enough; and the words 'any liability or duty' are clearly broad enough to include any breaches of duty causing injury or loss to private persons."

. . . . . .

"Thus, the statutory declaration of the necessity for control of holding companies in § 1 (b) (2), 15 U. S. C. A., § 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services.' The three specific sanctions stated in the Act—injunction, § 18 (f), 15 U. S. C. A. § 79r (f); criminal punishment, § 29, 15 U. S. C. A. § 79 z-3; and the negative relief of § 26 (b), declaring the contracts void—do not in terms place the defrauded operating company in statu quo; and § 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies."

The above cited section of the Public Utility Holding Company Act [§ 26 (b)] is identical to Section 47 (b) of the Investment Company Act of 1940. This Act, like the Public Utility Holding Company Act, is much more than a disclosure act. It is a Federal Corporation Code, superimposed on state law, regulating the internal affairs of every corporation engaged in the mutual fund business.

There have been several District Court decisions all upholding a private right of action against persons, in-

cluding directors, who breach duties imposed by the Investment Company Act of 1940.* Prior to the instant decision, no case has ruled on either of the two clear statutory bases of liability involved in this suit. Since the decision in the Court of Appeals, the District Court of the Southern District of New York has held that there are statutory duties imposed upon directors under Section 15 of the Investment Company Act of 1940. In that case, **Brown v. Bullock,**** **C. C. H. Federal Securities Law Reporter,** Current, Par. 91,013 (S. D. N. Y., 1961), Judge Herlands said (p. 93,385):

> "This court is in respectful disagreement with the views expressed in the Brouk case to the extent that they restrictively interpret the 1940 Act."

1. **Section 15 (c) of the statute makes it *ultra vires* and illegal to "renew or perform" any advisory contract, oral or written, without approval of the contract by a majority of the "unaffiliated" directors.** The Court of Appeals exculpated these respondent "outside" directors and emphasized that they did not profit from the unlawful payments. This does not excuse them from joint liability, if their acts constituted a breach of a duty under the Act and contributed to cause this loss. This is the *ad damnum* feature of the case, as petitioner may not obtain complete satisfaction from the tort-feasors, who profited.

Not only do the provisions of the Act relied upon impose duties upon directors, but Subsection 15 (c) imposes a

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* *Schwartz v. Bowman*, 156 F. Supp. 361 (S. D. N. Y., 1957), appeal dismissed, Schwartz v. Eaton, 264 F. 2d 195 (2d Cir., 1957); the *Brestwick* cases: *Brestwick & Co. v. United States*, 134 F. Supp. 132, 138 (S. D. N. Y., 1955); *Brestwick & Co. v. Briggs*, 135 F. Supp. 397 (1955); *Brestwick & Co. v. United States*, 138 F. Supp. 123, 131, reversed on other grounds; *Alleghany Corp. v. Brestwick & Co.*, 353 U. S. 151 (1957); *Cogan v. Johnston*, 162 F. Supp. 907 (S. D. N. Y., 1958).

** The Second Circuit has recently permitted an interlocutory appeal from this decision.

specific duty on "unaffiliated" directors regarding the approval of advisory contracts. That section provides that it is "unlawful" for advisory contracts to be renewed or performed "unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party. . . .".

This section manifestly places supervisory duties upon those members of the board who are not affiliated with the adviser, to prevent the latter from making its own self-dealing, inside contracts. The statute contemplates that the unaffiliated directors are to be the "watch-dogs" for the shareholders in approving or disapproving (not rubber stamping) advisory contracts. These directors certainly have the duty not to extend, renew or pay out monies under a contract where the advisor-contractor is not doing the work and the contract is terminated by assignment under Section 15 (a) (4), and the relationship is void under the Act, 47 (b).

Here is what the Court said about the duties of directors under Section 15, in the post-decision case of **Brown v. Bullock**, supra, p. 93,375 of C. C. H. Federal Securities Law Reporter, Current:

> "The directors are thus charged by the Act with critically important powers and duties of a specific nature. Each year they must pass upon the extension of the investment advisory contract, unless they refer the decision to the stockholders; they (the directors) have the authority to terminate the contract 'at any time' on sixty days' notice; and, when the contract is made or is to be renewed, there must be a majority of the disinterested directors.
>
> "The grant of these defined powers, as specified by the Act, carries with it the imposition of corresponding

duties. The power to extend the investment advisory contract necessarily carries with it the duty to determine whether or not the extension is desirable and in the best interest of the company. The power to terminate the investment advisory contract necessarily carries with it the duty to keep alert for reasons which might make termination necessary or desirable; and, in the presence of such reasons, to exercise the right of termination. The objectives of the Act would be nullified if the directors were free to extend mechanically the contract without honestly exercising their best judgment. The objectives of the Act would be equally frustrated if the directors were free to close their eyes to any developments making the termination of the contract advisable.

"By giving the directors the right to extend and to terminate the contract, the Act necessarily also imposes upon the directors the fiduciary duty to use these powers intelligently, diligently and solely for the interests of the company and its stockholders. These specific fiduciary duties are created by the Act. Their violation subjects the directors to liability, which can be enforced in the federal courts under section 44 of the Act."

2. **Section 15 (a) makes it illegal under any circumstances to initially employ an adviser unless such contract is initially approved by shareholders.**

The Jaquith contract was made by the inside directors through their alter-ego, Slayton Associates. It was performed for five and one-half years without any approval of shareholders. The directors have a duty to require submission of such an advisory contract to the shareholders.

Section 15 added to every investment company charter a new *ultra vires* clause, concerning the requisite approval of advisory contracts. If directors exceed their powers as

defined by this statute, they are liable for losses or damages resulting from such unlawful and void advisory contracts.

If directors who know that advisory contracts of this kind must be approved by shareholders and that the shareholders have not approved such contracts, they are exceeding their statutory powers and thereby violating the duty imposed upon them by statute (not by common law) when they knowingly operate with such an adviser. The unapproved advisory contract was not only illegal, but void [Section 47 (b)]; the directors have a statutory duty not to pay out money under such a void contract.

3. **The Directors have a duty to require adherence by the Fund to its stated investment policy and not participate in causing a deviation from such policy.** There is another substantive regulation of investment companies manifestly aimed at management by the Board of Directors requiring declaration by the management of investment policies which were deemed fundamental [Section 8 (b) (2)], and making it illegal to deviate from such policy without approval of shareholders [Section 13 (a) (3)]. These sections which require adherence to stated policy are also new, substantive Federal regulations of such corporations. Fundamental investment policy is the function of the Board of Directors. The directors have a statutory duty to prevent or certainly not to cause or participate in causing a deviation from stated investment policy. The prohibition of the statute against fundamental change in the nature of the investment policy was not a mere common law prohibition. Violation was a breach of a statutory duty.

Legislative Intent. The Court of Appeals found there was no manifest legislative intent under the Act to imply statutory duties. They accepted cases cited by respondents where causation was not shown, or where the courts, in construing other acts, refused to imply a remedy be-

cause the duty breached ran in favor of a stockholder or investor.* The Court also determined legislative intention by making incorrect comparisons to other Securities Acts** and by its reference to only the construction of the legislative history referred to by respondents.*** Yet the Court, in considering this issue does not mention the express recitals contained in the Act itself.

These above-cited specific statutory sections are supplemented by the purposes stated in the Act and its legislative history, which clearly show a manifest legislative intent to imply director duties as to these particular violations. For example, the recital in Section 1 (b) (4) of the Act states that it is against the interest of the public and of investors, "when investment companies are managed by irresponsible persons". Clearly, this applies to the directors, implying not only a duty of vigilance, but certainly imposing a statutory duty not to aid and abet in the violation of the sections above mentioned.

Supplementing the above sections, prohibiting a deviation from stated policy, the recital in Section 1 (b) (6)

* *Hazard v. Farst*, 238 F. 2d 790 (2d Cir., 1956) Cert. denied, 353 U. S. 937; *Doyening v. Hazard*, 162 F. 2d 654 (3rd Cir., 1947); and *Birnbaum v. Newport Steel Corporation*, 193 F. 2d 461 (2d Cir., 1952).

** For example, the Court of Appeals said that the Investment Company Act of 1940 has no express provisions imposing liability on directors such as the section 16 (b) of the Securities and Exchange Act, 78p (b) of Title 15, U. S. C., prohibiting "insider profits". The Court was simply wrong here as there is a section of the Investment Company Act of 1940, Sec. 30 (f), 80a-29 (f), prohibiting insider profits of closed-end companies. (The stock of closed-end companies is traded other than redeemed as in the case of open-end compa[illegible]e there is no opportunity for insider profits.)

*** Respondents put great emphasis on the omission in the final draft of the bill of the provision in an earlier draft requiring registration of directors. But, such deletion was cured by the statutory qualification of directors specifically set forth in Section 9 of the Act.

of the Act announces a legislative intent to prevent investment companies from making any "change (in) the character of their business . . . without the consent of security holders". And Section 1 (b) (2) provides that investment companies are not to be "operated, managed, or their portfolio securities selected, in the interest of directors, officers, investment advisors . . . ."

Section 9 of the Act relates to the eligibility of directors, and Section 10 limits affiliated directors to 60% of the Board. At the hearings in the Congress when this bill was passed, a representative of the Securities and Exchange Commission stated that the requirement of 40% independent directors "is one of the most salutory provisions of this bill". (Hearings before the Sub-committee of the House Committee on Interstate and Foreign Commerce, H. R. 10065, 75th Congress, 3rd Sess., at 109 [1940].)

Space does not permit a full discussion of the significance of the Act's legislative history or other sections of the Act which show the legislative intent to impose statutory duties upon directors. Section 17 (h) (prohibiting exculpatory provisions as to the liability of directors), and Section 36 (sanctioning directors for gross misconduct or gross abuse of trust.) But again we refer the Court to the lengthy opinion in **Brown v. Bullock**, supra, where the Court gives a very learned treatment of the legislative history, which shows that the history of the Act supports rather than negates the liability of directors under the Act.

We agree with the Court of Appeals that this law was a compromise. There were those who wanted to outlaw completely self-dealing contracts.* The Act as passed per-

* Laretzki, The Investment Company Act of 1940, 26 W. U. L. Q. 303 (1941). Mr. Laretzki represented the closed-end companies in the negotiations.

mitted such contracts, but regulated the manner of approval and extension of such contracts. Such regulation carries with it corollary duties of the directors designated by the Act to control self interest. In addition, Congress provided that contracts made contrary to the regulations set forth in Section 15 were void and opened the door, by Section 44, to the Federal courts (as well as state) to recover damages for breaches of such duty.

B. The Complaints allege breaches of these duties by respondents to the damage of the Fund.

On a motion such as respondents', attacking jurisdiction, the rule is that the court should decide the case on the merits, whether plaintiff states a claim based upon the Constitution or Federal statute sued on, and such a complaint is sufficient unless the Federal question is "wholly unsubstantial or frivolous." **Bell v. Hood**, 327 U. S. 678 (1945);

The Court of Appeals has followed to the letter respondents' construction of petitioner's complaint, that it is "insurers liability." But, "'the party who brings a suit is master to decide what law he will rely upon.'" **Bell v. Hood**, supra, 681, quoting from **The Fair v. Kohler Die & Specialty Co.**, 228 U. S. 22 (1913). We have insisted all along that it is not insurers liability (liability without fault) which the Fund seeks to impose on respondents. Again, these directors were obligated by the Act to control particular self-dealing arrangements. This was **their** duty. The complaints allege that the directors knowingly participated, aided and abetted the insiders to violate the Act (R. 6, 19).

Here is what the **Josephson** complaint alleged (R. 19):

> "... that the directors of MF have approved, acquiesced in, ratified, committed and are committing the very wrongful, willful and illegal acts complained

> of herein, and the said directors are serving with the approval of, domination and control of the Slaytons and are beholden and completely subservient to their wishes, direction and control . . ."

This is not insurers liability, and we do not have to label respondents as "conspirators" as the Court of Appeals seems to imply.

Petitioner need only state a claim under Rule 8 (a) of the Federal Rules of Civil Procedure. On a motion to dismiss, the complaint "should be construed in the light most favorable to plaintiff" and such motion should be overruled "if it can reasonably be construed that the plaintiff can make a case upon trial." **Jung v. K & D Mining Co.**, 260 F. 2d 607 (7th Cir., 1958). In determining the sufficiency of a complaint, the accepted rule is "that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." **Conley v. Gibson**, 355 U. S. 41, 45, 46 (1957).

The Fund's complaint alleged that defendants, including respondents, had knowledge of the provisions of the Act (R. 4). It is specifically alleged that all defendants, including these respondents, "committed, or with actual or constructive knowledge, . . . aided, abetted, acquiesced in or condoned, directly or indirectly", the said violations of the Act (R. 6). The defendant directors "committed" the acts complained of (R. 19).

These allegations tie in directly to show a breach of the above statutory duties by respondents.

1. These respondents knowingly approved contracts for advisory service each year for five years, with a corporation which they knew was not performing the serv-

ices for which it was being paid, which had abdicated and illegally assigned its contract to the brokers. Slayton Associates (the alter-ego of the inside directors) was employed by the Fund as the disclosed investment adviser "pursuant to successive written contracts . . ." from August 15, 1952, and continuing until the date of the commencement of this action (R. 14). The outside directors' affirmative acts in knowingly renewing the lucrative contracts with this shell corporation were positive breaches of their statutory duty. These affirmative acts permitted the payment of over $1,000,000 for services which were not rendered. But for such approval, required by Section 15 (c), there would have been no authority for such payment.

2. At the same time the respondents approved the above contracts, they knowingly permitted the Fund to operate with a broker-adviser whose contract was not disclosed or approved by stockholders nor formally approved by themselves. They are alleged to have aided and abetted in the paying out of over $1,500,000 to the brokers under this second unlawful contract.

3. It is alleged that "the acts of the defendants have violated the primary and principal policy of 'capital growth'" (R. 16). The complaints specify that what was done was to churn the portfolio and to distribute the capital gains (dividends)—a function of the board of directors (R. 16). This was for the benefit of the "insiders" (R. 5). The policy followed by these directors resulted in gross "mismanagement" to the benefit of the insiders (R. 6).

The Act imposes statutory duties on directors. Petitioner's complaint alleged breaches of these duties by respondents and the Trial Court, therefore, properly ruled that it had jurisdiction.

II. **The decision which the Court of Appeals has rendered is in conflict with the Court of Appeals for the Second Circuit on the same matter, namely construction of parallel sections of the Public Utility Holding Company Act and the Investment Company Act of 1940.**

The decision rendered by the Court of Appeals is in conflict with **Goldstein v. Groesbeck**, *supra*, 142 F. 2d 422 (2nd Cir., 1944). While the **Goldstein** case was decided under the Public Utility Holding Company Act, the case dealt with liability for monies paid under service contracts which were unlawful under that Act. The court there effectuated the Congressional intent of that Act and the substantive section of that law declaring unlawful contracts void.

Although the **Goldstein** case does not deal with as many or as flagrant violations of the law as are present here, the complaint there was held sufficient against the directors therein sued. Nor did it appear in that case that the directors participated in the violations charged, other than being directors of Ebasco.

Yet the Court of Appeals here has sought to distinguish **Goldstein**, p. 914 of 286 F. 2d, by saying that plaintiff in **Goldstein** sought profits "gained by the construction and service corporation and certain of their officers and directors." But there is nothing in the decision in that case to indicate that the directors of Electric Bond and Share Company, or Ebasco, profited. Rather, the action in **Goldstein** was "to account for profits received by Ebasco" (142 F. 2d 424). It would appear then that the directors were subjected to joint liability.

The Court of Appeals also attempted to distinguish **Goldstein** in that the "void contract theory requires privity." But in **Goldstein** there was no privity of contract as to the directors there sued.

The Court of Appeals, p. 914, 915 of 286 F. 2d, also cited 15 U. S. C. A., 78cc (b), being the 1938 amendment of the void contract section of the Securities and Exchange Act of 1934, and quoted said section, containing a statute of limitations, as if this section somehow distinguished **Goldstein** from the instant case. Said limitations are **not** contained in the void contract section (Sec. 79z) of the Public Utility Holding Company Act, relied on in **Goldstein**. The Court in **Goldstein** cited the section of the Exchange Act not as as obstacle but as additional reasoning supporting a Congressional intent to create a civil liability of directors.

The "void" section of the Holding Company Act (79z) was an important section relied on in **Goldstein** supporting its decision, as quoted by this Court, Opinion, p. 28. Said Section 79z is identical to the void contract section of the Investment Company Act, 47 (b), and it would appear, therefore, that the **Goldstein** case is a clear precedent here, and that the void contract section of the Exchange Act containing a limitation, could hardly be support for denying liability here or an indication of a Congressional intent (by the absence of a limitation) to make 47 (b) a nullity.

Conclusion: The issue here is neither non-feasance nor mere negligence. The issue here is liability of directors for irresponsible violation of law in the management of other people's money. Even when they do not directly profit by the unlawful operation, they have lent their names to the enterprise and must be held to have accepted the responsibility and duties specifically imposed by the statute. As joint tort feasors, they must be held to respond in damages if they violate the very provisions of the law which they are appointed to enforce, wherever such violation of duty causes losses to the investors.

The Court of Appeals overlooked new standards of responsibility for both inside and disinterested directors, new duties in safeguarding and preventing self-dealing

operations. The action against these directors is for damages. The Fund must, of course, prove damages proximately caused by respondents' breach of statutory duty. For such damages petitioner should be entitled to recover from respondents. That is why Congress made illegal the corporate acts approved by these directors and created a new substantive law, voiding inside contracts. Is there no remedy against the managers who violated this Act?

Some of the directors are located in various parts of the country and this is why the Congress included in Section 44 the long arm provision for service of process. Such a case should be tried in a Federal tribunal with all joint tort-feasors before the Court. A body of Federal law should evolve construing this Act. **Textile Workers Union v. Lincoln Mills**, 353 U. S. 448 (1957).

For all of the foregoing reasons, it is respectfully submitted that this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

(Opinion Below.)

UNITED STATES COURT OF APPEALS
For the Eighth Circuit.

No. 16,566

J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr. et al., Appellants,

vs.

Managed Funds, Incorporated, et al., Appellees.

Appeal from the United States District Court for the Eastern District of Missouri.

[January 13, 1961.]

Before Woodrough, Van Oosterhout, and Matthes, Circuit Judges.

Woodrough, Circuit Judge.

These appeals are taken from an order of the District Court which denied motions made by appellants to dismiss for lack of jurisdiction of subject matter or person or both in two actions brought against appellants and others by Managed Funds Incorporated and by one Emanuel Josephson. The actions had been consolidated and the order determined that the motions to dismiss the complaints for want of jurisdiction involved a controlling

question of law upon which there is a substantial ground for difference of opinion and that an immediate appeal from the Court's order may materially advance the ultimate determination of the litigation. Pursuant to application to this Court to appeal under Section 1292(b), 28 U.S.C.A., the appeals were allowed to review the District Court's ruling on the motions to dismiss as related to the claims asserted against these appellants and the denial of appellants' motion to dismiss on jurisdictional grounds.

The plaintiff Managed Funds Incorporated, is a registered open end investment company within the purview of the Investment Company Act of 1940 (54 Stat. Sec. 798-847; 15 U.S.C.A. 80(a) et seq.) Prior to the commencement of the present actions a stop order proceeding was had against it before the Securities and Exchange Commission under Section 8(d) of the Securities Act and a stop order was issued by the Commission upon extensive findings. In re Managed Funds Inc. Par. 76,662, C. C. H. Federal Securities Law Reporter, Current.

The general object and nature of the present consolidated actions is an accounting, injunction and recovery of money damages by Managed Funds for alleged violations of the Investment Company and the Investment Advisers Act of 1940 which are in general the same violations found by the Commission.

The *Josephson* case is a stockholders' derivative action prosecuted for and on behalf of Managed Funds, Inc., but in which Managed Funds, Inc., is named as a defendant. The *Managed Funds* case is a direct action by the corporation itself embracing the same general factual background.

Emanuel Josephson filed the derivative action in the United States District Court, District of Delaware. Managed Funds, Inc., filed its action in the United States District Court, Eastern District of Missouri.

Defendants, Hilton H. Slayton and Hovey E. Slayton, were officers and directors of the fund and owned or controlled defendant, Slayton Associates, Inc., the Funds' Investment Adviser and defendants, Slayton and Company, Inc. and Mutual Fund Distributors, Inc. which were engaged in the selling of Funds' shares. Defendant, Model, Roland & Stone, is a stock brokerage partnership composed of the individual defendants indicated. These appellants and defendants, Boas, Cunningham, Hicks, Jester, Shields and Stubbs are former members of the Board of Directors of Managed Funds, Inc.

The Josephson complaint rests jurisdiction on the claimed violation of the Investment Company and Adviser's Act of 1940, and rules of the Securities and Exchange Commission promulgated thereunder. Managed Funds' Amended Complaint rests jurisdiction on alleged violations of the Investment Company Act of 1940 and rules of the Securities and Exchange Commission promulgated pursuant to it.

Appellant, Jefferson J. Rebstock, and appellant, Earl R. Rice, are citizens and residents of the State of Louisiana. They appeared specially and by motions sought dismissal of the four counts of Funds' amended complaint for lack of jurisdiction of both subject matter and person. Appellants, W. Munro Roberts, Jr., J. John Brouk and James J. Mullen, Jr., are citizens and residents of the State of Missouri. They moved to dismiss for lack of jurisdiction of subject matter. Like motions were filed respecting the Josephson complaint and the adoption thereof by Protective Casualty Insurance Company. Simila, motions were filed by all appellants on this appeal.

These appellants and some other directors are denominated by Fund in the Amended Complaint as "outside directors", that is directors alleged to have had actual or constructive knowledge of the alleged wrongful acts of the

Slaytons individually and the Slayton Companies and broker defendants.

The facts pleaded in Count I of Funds' Amended Complaint are substantially as follows:

That the plaintiff, Managed Funds, Incorporated, is a registered open end investment company under the Investment Company Act selling its shares to the general public through underwriters, distributors, dealers and salesmen. That Fund entered into a contract with Slayton Associates, Inc., whereby it became "Funds' Investment Adviser" for agreed compensation of ½ of 1% of the asset value of Funds' asset portfolio, consisting of shares of common stock of various companies. That in December of 1953, Slayton Associates, Inc. employed defendant, Jaquith, as investment counselor and manager of Funds' securities portfolio and delegated its duties as investment adviser to defendant, Jaquith; that Slayton Associates, Inc., agreed to pay Jaquith, $50,000.00 a year for five years beginning in December of 1953, and a minimum of $35,000.00 a year for the next succeeding five years, which payments were to be applied against brokerage commissions Jaquith or his designees would receive respecting Funds' brokerage business channeled to Jaquith; that Jaquith channeled Funds' business to the stock brokerage partnership of Model, Roland and Stone, defendant herein, of which Jaquith was a member, whereby such partnership received brokerage commissions of over $1,500,000.00; that Jaquith and Model, Roland and Stone paid $50,000.00 a year to defendants Smith and Stubbs, for which no services were performed, it being averred that Stubbs is a former business associate of the Slaytons and an employee and representative of Model, Roland and Stone, a former director of the Fund; that defendant, Smith, is also an employee and representative of defendant, Model, Roland and Stone, and a brother-in-law of defendant, Hovey E. Slayton.

That Funds' announced policy in offering its shares as contained in reports and prospectuses filed with the Securities and Exchange Commission was to provide for capital growth and reasonable income consistent therewith by realized profits on the sale of portfolio securities and dividends; and to make quarterly distributions to its shareholder; that after the arrangement with Jaquith, it is averred this policy was not followed, and distribution to shareholders were made of a predetermined income to meet which it was required that capital gains be realized, thereby permitting defendants, Slayton and Company, Incorporated, and Mutual Fund Distributors, Incorporated to make greater commissions and profits from the sale of Funds' shares. This policy, it is averred, resulted in mismanagement, loss and damage to Funds' investment portfolio by increased brokerage commissions for purchase and sale of portfolio securities and greater payments to Jaquith by Slayton Associates, Inc.; that Fund was caused to place its brokerage business for the sale of portfolio securities with brokers who also sold Funds' shares, and with brokers who rendered services to Slayton Associates, Inc., and to Slayton and Company, Inc., and Mutual Fund Distributors, Inc. seller and distributor of Funds' shares to satisfy obligations of companies for services rendered to them.

By paragraph 21 of Count I of the Funds' amended petition, it is averred that:

> "The defendants committed, or with actual or constructive knowledge, as herein above set forth, aided, abetted, acquiesced in or condoned, directly or indirectly, violations of the Investment Company Act of 1940."

by (a) operating the fund in the interest of directors, etc., rather than Funds' security holders, [15 U.S.C.A. 80a-1 (b)2] caused Fund to publish and circulate documents

containing untrue statements or omitting material facts, [15 U.S.C.A. 80a-33]; (c) caused Fund to deviate from a fundamental investment policy, [15 U.S.C.A. 80a-13] and (d) that defendants, Model, Roland and Stone and Jaquith, acted as investment advisers without a written contract approved by the outstanding voting securities of Fund. [15 U.S.C.A. 80a-15(a)]

Count II of Funds' Amended Complaint avers that the Court has jurisdiction of Count II because it is based on the same acts alleged in Count I of which the Court has jurisdiction under the Investment Company Act. And it is averred that Fund may be liable to purchasers of its shares by reason of the defendants having caused Fund to file false registration statement required by the Securities Act of 1933; that the Securities and Exchange Commission issued a stop order and that Funds' name and good will were damaged, and that Fund expended money for counsel fees and other expenses in connection with the Securities and Exchange proceedings.

Count III bases jurisdiction on the same grounds as Count II and avers that Slaytons individually occupied a fiduciary relationship with Fund as Funds' President and Vice-President; that Model, Roland and Stone and Jaquith acted as investment advisers and therefore occupied a fiduciary relationship; that each of the other defendants had actual knowledge of the fiduciary relationship of the Slaytons to the Fund, and constructive knowledge of the fiduciary relationship of Model, Roland and Stone and Jaquith to the Fund; that the Slaytons and Model, Roland and Stone breached their fiduciary duties, committed waste and mismanaged Fund, and all except for the "outside directors" profited thereby; that all defendants, including the "outside directors" by reason of actual knowledge or constructive knowledge of the fiduciary relationships of the Slaytons and Model, Roland and Stone to Fund are liable for their acts.

Count IV adopts the allegations of Count I except paragraphs 20, 21 and 22 and paragraphs 3 through 6 of Count III, and avers a conspiracy between all defendants, except the "outside directors" who, it is averred, had actual or constructive knowledge and failed to do anything to prevent the actions of the other defendants, and are therefore liable to Fund.

Prayer of each of the Counts is for money damages, and for an accounting for profits as to all defendants.

The Josephson complaint recites the same basic facts as Count I of Funds' Amended Complaint and the same violations by Fund, and avers that "the wrongful acts herein described have been and continue to be committed by the defendants against Managed Funds in breach of legal and fiduciary obligations that are inherent by reason of the relationship of the parties". Josephson prays for an injunction in addition to an accounting and damages.

The District Court of Delaware transferred the *Josephson* case to the United States District Court, Eastern District of Missouri and the cases were consolidated.

Pursuant to an order entered by the District Court, the Protective Casualty Insurance Company, a corporation, was allowed to intervene as a party plaintiff in the *Josephson* case. The Protective Casualty Insurance Company, as an intervening party, adopted the complaint of Emanuel Josephson as its complaint.

On July 1, 1960, the District Court, by its order, denied each and all of the appellants motions to dismiss for lack of jurisdiction of subject matter and or person.

The points presented by appellants for reversal of the order are: 1. That the Investment Company Act of 1940 does not expressly or by implication create any statutory duty or liability respecting directors of an investment company, the violation of which gives rise to a cause of

action by such investment company against these directors which is within the jurisdiction of the District Court of the United States. 2. Mere violations of the federal statute does not as a matter of general law create a case of which Federal Courts have jurisdiction and the theory of federal jurisdiction by implication has been rejected in security cases where corporations have sought to hold directors for claimed statutory violations and mismanagement or breach of duty. 3. The legislative history of the Investment Company Act of 1940 discloses a complete lack of congressional intent to create a body of federal law respecting liability of directors of investment companies.

In support of the first point appellants recall that the Federal Courts are not courts of general jurisdiction but are courts of special or limited jurisdiction in that they have no jurisdiction except that conferred by the Constitution and laws of the United States, 54 Am. Jur. United States Courts Sec. 10, p. 671 and that:

> "A suit to enforce a right which takes its origin in the laws of the United States is not necessarily, or for that reason alone, one arising under those laws, for a suit does not 'arise' unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such a law, upon the determination of which the result depends." *Gully* v. *First National Bank*, 299 U.S. 109, 114.

Appellants point out that neither complaint here involved attempts to base jurisdiction on any federal statute other than the Investment Company Act and the Investment Adviser's Act of 1940 and that the claim of jurisdiction to be sustained must fall within the category of a right created by the act of Congress whereby jurisdiction is conferred upon the Federal Courts without regard either to diversity of citizenship of the parties or the amount in controversy.

The Investment Company Act of 1940, 15 U.S.C.A. 80a-1-52, and the Investment Advisers Act of 1940, 15 U.S.C.A. 80b-1-21, are the fifth in a series of six Congressional enactments relating to securities. The Securities Act of 1933, 15 U.S.C.A. 77a-77aa, the Securities Exchange Act of 1934, 15 U.S.C.A. 78a-jj, the Public Utility Holding Company Act of 1935, 15 U.S.C.A. 79a-z and the Trust Indenture Act of 1939, 15 U.S.C.A. 77aaa-77bbb each contain express provisions for private civil actions. See, 77k, 77l, 78i(e), 78r, 79p, and 77www. Directors may be sued under 77k. Under 78p(b) insiders profits may be recovered by an "issuer", or if it refuses to sue, through a security holder of an issuer in its name. There are provisions for limitations, joint liability and rights of contribution, 77m, 77k(l), 78aa and 77k. By contrast neither the Investment Company Act nor the Investment Advisers Act of 1940 contain any such provisions. The Investment Company and Advisers Acts neither make any definition of the duties of directors nor provide anywhere that a registered investment company may sue its directors.

Respecting jurisdiction of the District Courts, the Investment Company Act provides:

> "Sec. 80a-43. Jurisdiction of offenses and suits
>
> The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders, thereunder. Any criminal proceeding may be brought in the district wherein any Act or transaction constituting the viola-

tion occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in this district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and section 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter and section 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, Sec. 44, 54 Stat. 844."

The Advisers Act provides:

"Sec. 80b-14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceedings may be brought in

the district wherein any suit or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business, or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in section 225 and 347 of Title 28, and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title II, Sec. 214, 54 Stat. 856."

The jurisdiction section of the 1933 Act, 15 U.S.C.A. 77v, the Public Utility Holding Company Act, 15 U.S.C.A. 79y, and the Trust Indenture Act, 15 U.S.C.A. 77vvv, are substantially the same as 80a-43. The Exchange Act provides that the United States Courts have "exclusive jurisdiction" to enforce liabilities or duties created by that Act. 15 U.S.C.A. 78aa.

The express wording of the Investment Company Act above is that criminal jurisdiction for violations is exclusively in the District Courts of the United States and civil jurisdiction is concurrently in State Courts and Federal Courts "of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter * * *". The Advisers Act confers jurisdiction of violations and suits to enjoin violations, and says nothing about duties or liabilities of directors.

The absence of specific language creating civil liability respecting private actions narrows the jurisdictional question presented by this appeal to whether or not directors' liability to registered investment companies which they serve has been created by implication.

Under some of the federal legislation relating to security transactions federal jurisdiction of private actions has been upheld by implying a right of action respecting contracts declared void by the statute and by implying a right of action for damages in tort for violation of the federal statute.

Appellants recognize that the doctrine is well supported that a cause of action within the federal jurisdiction exists by implication in the security field in suits brought by purchasers of securities against sellers or by sellers against purchasers on account of violations more particularly under the 1933 and 1934 Acts. The record of the development of the doctrine is shown in the Annotation to *Fratt* v. *Robinson*, 203 F.2d 627, (1953) in 37 A.L.R. 2d 649 and it appears that the jurisdiction has been implied first under the general provisions of the Exchange Act, the Holding Company Act and the Investment Company and Investment Advisers Act to the effect that contracts in violation of the Acts or rules thereunder are void. The applicable Investment Company Act provision is as follows:

"Section 80a-46. Validity of contracts.

(a) Any condition, stipulation or provision binding any person to waive compliance with any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order

thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title 11, Sec. 47, 54 Stat. 845."

The second basis of liability, is "the common law tort doctrine of private action based on violation of a statute".

It is the position of appellants that the void contract theory of liability and the theory of tort liability based on violation of a federal statute has been rejected by the courts in situations where director liability to their corporation has been involved. Further, that the legislative history of the Acts here involved shows a complete absence of any legislative intent to create such private actions against directors by investment companies cognizable in the Federal Courts.

The appellants refer to the case of *Kardon* v. *National Gypsum Co. et al.*, (D.C.E.D. Pa., 1946) 69 F.Supp. 512, as the root case containing judicial pronouncement of the two theories on which federal jurisdiction has been implied.

This was a fraud case under the Exchange Act of 1934 to recover damages against the National Gypsum Com-

pany and others for inducing plaintiffs to sell their stock in two corporations for less than true value. The court was ruling on motions of defendant to dismiss for lack of jurisdiction of person and failure to state a claim. By Rule X-10B-5 implementing 78j, the Security Exchange Commission made it unlawful for any person to employ deceptive devices in the purchase or sale of securities. The Court stated the question was whether the conduct complained of gave rise to a liability or involved a breach of duty created by the 1934 Act and then held:

> "It is not, and cannot be, questioned that the complaint sets forth conduct on the part of the Slavins directly in violation of the provisions of Sec. 10 (b) of the Act and of Rule X-10B-5 which implements it. It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the Rule. However, 'the violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * *'. Restatement, Torts, Vol. 2,, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort."

The court also predicated liability on the void contract-theory saying:

> "Apart from Sec. 10 (b), I think that the action can also be grounded upon Sec. 29 (b) of the Act which provides that contracts in violation of any provision of the Act shall be void. Here, unlike the point just discussed, the question is purely one of statutory construction. It seems to me that a statutory enactment

> that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it. The statute would be of little value unless a party to the contract could apply to the Courts to relieve himself of obligations under it or to escape its consequences. Beyond this, however, as pointed out by Judge Coxe in *Geismar* v. *Bond & Goodwin, Inc.*, D.C., 40 F.Supp. 876, 878, the 1938 amendment which deals in part with actions 'maintained in reliance upon this subsection' clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it. And, as he further pointed out, such suits would include not only actions for rescission but also for money damages."

It is significant that in speaking of the void contract theory the court says a *party* may be relieved of contract obligations induced by violations and appellants insist that the Security Act provisions voiding contracts in violation of the Acts can apply, only where plaintiff and defendant in an action for relief under the Acts are in privity of contract or perhaps where plaintiff can work out a third party beneficiary relationship. None of appellants here are parties to the advisory contract between Associates and Fund or the contract between Associates Jaquith and Model, Roland and Stone. They say they can not be brought within the doctrine of *Kardon* v. *National Gypsum Co. et al.*, supra. Furthermore, that the defendants in the action were the ones charged with violating the Acts was conceded in *Kardon*, whereas appellants contend the complaints here charged no statutory duties or liabilities respecting directors which these directors have violated.

2.

Under their second point appellants contend that the courts have rejected implication of federal jurisdiction in director liability cases. They cite *Howard* v. *Furst* (2d

Cir. 1956) 238 F.2d 790, aff'd, S.D.N.Y. 140 F.Supp. 507. That was a derivative suit on behalf of Circle Wire & Cable Corporation against officers and directors of Circle who held over 60% of Circle's shares. There was no diversity. Federal jurisdiction was asserted under the Exchange Act of 1934, Section 78aa. The complaint alleged that Circle had an agreement to sell and a Cerro de Pasco Corporation an agreement to buy Circle's property and business for over twenty million dollars; that the individual defendants to advance their own private interest negotiated the sale for less than the value of the assets of Circle; that the sale would constitute a waste of Circle's assets; that the directors by virtue of their position and as controlling stockholders of Circle abused their fiduciary obligations. That a proxy statement of Circle's shareholders meeting to vote upon the sale was false and misleading, in that it understated the cost and value of Circle's inventory and its earnings and failed to disclose the private interests of the officers and directors of Circle. Section 78n (a) made it unlawful to solicit proxies by use of the mails in contravention of rules of the S.E.C. and by Rule X-14A-9 the S.E.C. had proscribed false or misleading material in proxy statements. The prayer for relief was to declare the proxies void; to enjoin certain individual defendants from voting, to declare the sale contract void, and to rescind it and restore the status quo and alternatively, if this be impossible, that Circle recover damages from Cerro and the individual defendants directors of Circle. In summing up the complaint the Court said: "In other words, appellant asserted a claim for an injunction against the sale, which, now that the sale has gone through, has become a claim for rescission or for the damages suffered by Circle, not by appellant". The Court sustained the action of the District Court, S.D.N.Y. 140 F.Supp. 507, dismissing the complaint for lack of jurisdiction of the subject matter, Circuit Judges Hand, Medina, and Hincks sitting. The Court said:

"As the case is said to be one 'arising under' the laws of the United States, our first inquiry is addressed to appellant's contention that the statutory provisions above quoted create or give rise to a substantive civil right on behalf of Circle, which may be enforced in a derivative action by an individual stockholder. We reject this contention as unsound. We find nothing in the language of Section 14 (a) or in the legislative history of the Securities Exchange Act of 1934 to warrant an inference that it was the intention of the Congress to create any rights whatever in a corporation whose stockholders may be solicited by proxy statements prepared in contravention of the statutory mandate."

The Court pointed out that where the 1934 Act created a corporate action for insider profits this was done by an express provision 15 U.S.C.A., Sec. 78p (b). Applying the federal right test of the *Gully* case, supra, the Court said:

"Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the state of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law."

Appellants also cite *Downing* v. *Howard*, 162 F.2d 654 (3rd Cir. 1947), aff'd, 68 F.Supp. 6 (D.D.C. 1947). The nature of the action is described by the Court as follows:

> "Plaintiff is the owner of shares of United Corporation (of Delaware), hereafter called United. He brought this action in the United States District Court for the District of Delaware on behalf of himself, other shareholders of United, and the Corporation against individuals or, in some instances, their personal representatives, who had been directors of United and certain other persons alleged by plaintiff to have conspired with the directors to the detriment of the Corporation. Most of the individual defendants are neither residents of Delaware nor engaged in business there. Plaintiff, however, says that he is properly in the federal court under Sec. 25 of the Public Utility Holding Company Act of 1935. He concedes that unless he has stated a cause of action 'created' by that statute his action in the District Court of Delaware will not lie."

By the third count it was claimed the directors failed to file with the SEC a plan of reorganization. The Court held:

> "The fatal obstacle to the plaintiff's complaint on this score is that the legislation does not require the company to furnish a plan. A cause of action can hardly be based upon disobedience of the statute when the statute does not require the act, the non doing of which is complained of by the plaintiff. Plaintiff's complaint, therefore, as to this cause of action stops at this point so far as it is predicated upon liability under the federal statute."

By the first count it was alleged the directors failed to register United and that while United was unregistered it held securities which depreciated $87,000,000.00. The Court held there was no duty on a registered company to

sell its securities, hence failure to register had no legal connection with the loss. Count two, also based on failure to register averred that an option exercised by directors which turned out to be a bad guess would not have happened if United was registered. The Court said:

> "Plaintiff's theory is that if United had refrained from voting and exchanging as required by Sec. 4 (a) (6), 4 (a) (3), and 4 (a) (4) of the Act, there would have been no loss since the consolidated preferred has maintained its market value and all accumulated dividends have been paid . . . Plaintiff does not allege, and we do not know, what would have happened with regard to this exchange of shares had United been registered and all the facts which a registration requires had been brought out. Even if the plaintiff had alleged that the exchange would never have taken place if United had been registered the complaint would still stop short of being legally sufficient unless it stated facts showing that the loss suffered happened in a way the statute was enacted to prevent. This he failed to do. We do not think, therefore, that what plaintiff complains of was occasioned either by owning or exchanging unless, as discussed above, the statute violator is to be held to complete insurer's liability."

District Judge Leahy in dismissing the *Downing* case below summarized his views as follows:

> "Clearly, then, the suit at bar is not a 'suit in equity * * * brought to enforce any liability or duty created' by the Act. Absent other jurisdictional elements, a minority stockholder may not resort to the federal courts on simple allegations that directors and officers, with other coconspirators, have violated federal statutes—such as anti-trust laws and the Interstate Commerce Act, 49 U.S.C.A. Sec. 1 et seq.—in addition to committing breaches of fiduciary duty." 68 F.Supp. at 10.

Birnbaum v. Newport Steel Corporation, 193 F.2d 461, (2d Cir., 1951) is also cited. There the Second Circuit had before it a suit brought on behalf of the Newport Steel Company by shareholders alleging jurisdiction under the Securities Exchange Act of 1934, 15 U.S.C.A. 78aa. Violation of fiduciary obligations by directors was pleaded in selling their stock in Newport and making fraudulent reports to Newport's stockholders. It was claimed S.E.C. Rule X-10B-5 was violated. The Court held that the claimed violations had no relation to breach of fiduciary duties by corporate insiders which resulted in fraud upon stockholders who were neither buyers nor sellers. (the protected class under the 1933 and 1934 Acts).

The Court rejected plaintiff's contention that the rule supplemented the common law liability of those who abuse the trust of their corporate positions and created a federal case and said:

> "But the appellants argue that such an interpretation of the Rule is too narrow to carry out the broad purpose of the Act to protect investors 'from exploitation by corporate insiders'. * * * We do not doubt that Congress was at least partially motivated by such a purpose in enacting the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78a et seq. However, the precise question here is whether Section 10(b) of the Act and the Commission's Rule X-10B-5 were the means chosen to further that end, and we are of the opinion that the legislative 'history' and 'purpose' quoted by appellants are not persuasive that they were. When Congress intended to protect the stockholders of a corporation against a breach of fiduciary duty by corporate insiders, it left no doubt as to its meaning.[1]

[1] We observe that when Congress intended to create a federal case of director liability it made its meaning clear. The National Banking Act provides that directors of a National Bank who knowingly permit any of the officers, agents or servants of the association to violate any provisions of the Act, every director who

Thus Section 16 (b) of the Act of 1934, 15 U.S.C.A. Sec. 78p (b) a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. The absence of a similar provision in Section 10 (b) strengthens the conclusion that that section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller. Since the complaint failed to allege that any of the plaintiffs fell within either class, the judgment of the district court was correct and is accordingly affirmed."

The appellants then cite non-security cases illustrating lack of federal jurisdiction when none is legislatively conferred as follows:

Meyer et al. v. *Kansas City Southern Railway Company* (2 Cir. 1936), 84 F.2d 411, stockholders derivative action for conspiracy against railroads and directors alleged violation of antitrust laws;

Jacobson v. *New York, N. H. & H. R. Co.* (1 Cir. 1953), 206 F.2d 153, violation of Safety Appliance Acts;

Consolidated Freightways v. *United Truck Lines* (9 Cir. 1954), 216 F.2d 543, violation of Motor Carrier Act;

Miller v. *Long* (4 Cir. 1945), 152 F.2d 196, violation of National Housing Act;

Republic Pictures Corp. v. *Security First National Bank* (9 Cir. 1952), 197 F.2d 767, case involving mortgage on a copyright;

State Automobile Ins. Ass'n v. *Parry* (8 Cir. 1941), 123 F.2d 243;

participated in or assented to the same is to be held liable in his personal and individual capacity for all damages which the association, its shareholder or any other person shall have sustained in consequence of such violation 12 U. S. C. A., Section 93.

Note: 14 A.L.R. 2d 992—What actions arise under the laws and treaties of the United States so as to vest jurisdiction of Federal Courts.

3.

As to the lack of congressional intent to create a body of federal law respecting liability of directors of investment companies. Such review as we have been able to make of the legislative history has afforded little assistance either in justifying or refuting the implication of a private right of suit such as claimed here. Senate and House Committees reports are devoid of clear reference to civil liability except with respect to provisions expressly imposing it. We are cited to the analysis of the Investment Company Act of 1940 in 50 Yale L. J. 441, 446, that "the original draft of the section" (now 15 U.S.C.A. 80a-9) "which required all investment company officers and directors to register as individuals with the S.E.C. and become subject to such disqualification as that body should propose drew a storm of protest from the industry." As passed, the director registration requirement was deleted. The original bill had further provided that if any person registered under the Act was guilty of gross misconduct or gross abuse of trust he would be guilty of a crime. This provision was omitted from the Act. The note in the journal continued by saying, that; "It was suggested during the hearings on the original bill that this whole problem" (managerial responsibility) "could be solved most expeditiously by declaring investment company managements to be trustees in fact with trustee obligations to their stockholders.". This proposal, however, which would have involved drastic managerial responsibility, was rejected except to the extent that "gross abuse of trust" was made a ground for restraining the guilty party from further connection with the industry. The "gross abuse" section referred to is 15 U.S.C.A. 80a-35 and the

Securities and Exchange Commission is the one there authorized to bring the action.

Congress did refrain from including in the Acts any control or regulation or expansion of the common law duties of directors of investment companies and the failure to provide any private civil remedies or for joint and several liability or contribution or statutes of limitation such as are found in the 1933 and 1934 Acts indicates that the omission was deliberate. At common law directors are liable to exercise due care and to render them liable by implication on account of violations of the Acts by others would be a drastic innovation.

Senator Lodge of Massachusetts stated in the Senate on June 21, 1940, in urging the passage of the present Act:

> "It so happens that the investment trust business is one which very largely had its origin in Boston and I happen to know a great many people connected with this industry. * * *
>
> This bill, as the Senator from New York has said, was agreed upon after very painstaking and careful study, in which really almost a miracle occurred, in that all the various elements in the industry were able to get together and organize themselves, and present a common basis for studying the question, and as the result of that effort an agreement which is embodied in this bill was reached between those engaged in the industry and the members of the S.E.C. I submit that that is a very unusual and very beneficial occurrence——."

It seems improbable that there would have been such unanimity for the passage of the Act if it had been thought to impose any such per se liability on directors as is claimed by plaintiffs here. The failure to provide for any private civil remedies or for joint and several liability of directors and persons who commit or contrib-

ute to violations or for statutes of limitations or for conditions is persuasive that the omission was deliberate. Certainly, the Courts will imply a liability only to implement a manifest legislative intent. The enactments as they stand do not justify implications that jurisdiction was intended to be conferred.

The appellees in support of the jurisdiction and the ruling appealed from contend that the facts alleged in the complaints state a claim upon which the Investment Company Act of 1940 provides a remedy to Managed Funds and against appellants in the Federal District Court. They have cited and relied on the following provisions of the Act and texts and decisions:

Alfred Inv. Trust et al. v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945)
Alleghany Corporation v. *Breswick & Co.*, 353 U.S. 151 (1957)
Baird v. *Franklin*, 141 F.2d 238 (2d Cir., 1944)
Bell v. *Hood*, 327 U.S. 678 (1945)
Birnbaum v. *Newport Steel*, 193 F.2d 461 (2d Cir., 1951)
Brandt v. *Renfield*, 278 F.2d 904 (8th Cir., 1960)
Breswick & Co. v. *United States*, 134 F.Supp. 133 (S.D.N.Y. 1955), 138 F.Supp. 123 (1956)
Breswick & Co. v. *Briggs*, 135 F.Supp. 397 (1955)
Cogan v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y., 1958)
Collings v. *Busch Manufacturing Co.*, 19 F.R.D. 297, (S.D.N.Y., 1956)
Downing v. *Howard*, 68 F.Supp. 6 (D. Del. 1946) 162 F.2d 654 (3d Cir., 1947)
Errion v. *Connell*, 236 F.2d 477 (9th Cir., 1956)
Fielding v. *Allen*, 181 F.2d 163 (2d Cir., 1950)
Fischman v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951)
Fratt v. *Robinson*, 203 F.2d 627 (9th Cir., 1953)
Goldstein v. *Groesbeck*, 142 F. 2d 422 (2d Cir., 1944)

Gully v. *First National Bank in Meridian*, 299 U.S. 109 (1936)

Hawkins v. *Merrill Lynch, Pierce, Fenner & Beane*, 185 F.Supp. 104 (W.D.Ark., 1949)

Hooper v. *Mountain States Securities Corporation*, Par. 90,972, C.C.H. Federal Securities Law Reporter.

Howard v. *Furst*, 238 F.2d 790 (2d Cir., 1956)

Hurn v. *Oursler*, 289 U.S. 238 (1933)

R. H. Johnson & Co. v. *S.E.C.*, 198 F.2d 690 (2d Cir., 1952)

Jung v. *K & D Mining Co.*, 260 F.2d 607 (7th Cir., 1958)

Kardon v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D.Pa. 1946), 73 F.Supp. 798 (1947)

In re Managed Funds, Incorporated, Par. 76,662, C.C.H. Federal Securities Law Reporter, Current.

Schwartz v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y. 1957)

Schwartz v. *Eaton*, 264 F.2d 195 (2d Cir., 1959)

Slavin v. *Germantown Fire Ins. Co.*, 174 F.2d 799 (3rd Cir., 1949)

Sparks v. *England*, 113 F.2d 579 (8th Cir., 1940)

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957)

Stella v. *Kaiser*, 82 F.Supp. 301 (S.D.N.Y., 1948)

Taussig v. *Wellington Fund, Inc.*, Par. 90,979, C.C.H. Federal Securities Law Reporter, Current 187 F.Supp. 179, (D.Del., 1960)

Statutes Cited:

79j (Rule X-10B-5), 78aa, 78p of Title 15, U.S.C.A., 79y, 79z of Title 15, U.S.C.A.

80a-1 (b) of Title 15, U.S.C.A.

80a 2 (a) (19) of Title 15, U.S.C.A.

80a-8 (b) of Title 15, U.S.C.A.

80a-10 of Title 15, U.S.C.A.

80a-13 (a) (3) of Title 15, U.S.C.A.

80a-15 of Title 15, U.S.C.A.

80a-16 of Title 15, U.S.C.A.
80a-33 of Title 15, U.S.C.A.
80a-43 of Title 15, U.S.C.A.
80a-46 (b) of Title 15, U.S.C.A.
80a-47 of Title 15, U.S.C.A.
Rules Cited:
Rule 8a Federal Rules of Civil Procedure.
Texts Cited:
Congressional Record, 1940, P. 10074
Green, George Washington Law Review, Vol. 28
Jaretski, 26 W.U.L.Q. 303
61 Harvard Law Review 858
Report of Hearing of H.B. 100065, Subcommittee of Committee of Interstate and Foreign Commerce (76th Congress, 3rd Session)
Restatement of the Law of Torts, Section 286
Senate Report No. 1775, 76th Congress, 3rd Session June 6, 1940.

In the first place, the appellees stress the decision in the *Kardon*-case, supra, and the fact that the Court there found federal jurisdiction by implication both because the defendant had violated a legislative enactment causing damage to plaintiff and because the statute declared that the contract so obtained in violation "shall be void". We do not express disagreement in any respect with the *Kardon* decision and others in accord with it. In *Kardon* the party damaged by a contract obtained in violation of a federal law, which contract the law made void, was allowed to sue in federal court the party who offended and profited. But we do not hold the situation here to be analogous.

Goldstein v. *Groesbeck*, 142 F.2d 422, (2d Cir., 1944) involved a void contract under the Holding Company Act. Defendant, Electric Bond & Share, was the top holding company and through American Power & Light it controlled four power companies. It had construction con-

tracts with the power companies and caused the contracts to be taken over by corporations organized by it. By the Act it was unlawful for an unregistered holding company to enter into construction or service contracts with public utilities. Goldstein brought the action as a shareholder of American derivatively for American and the controlled power companies to compel an accounting for profits gained by the construction and service corporations and certain of their officers and directors. The court decided that but for the Act the payment under the contracts would have been lawful, therefore, "the words 'any liability or duty' are clearly broad enough to include any breaches of duty causing injury or loss to private persons." The void contract theory is enunciated as follows:

> "As we have seen, the Act makes it unlawful for unregistered holding companies to enter 'directly or indirectly' into service or construction contracts . . .
>
> Violation being thus established, Sec. 26 (b), 15 U.S.C.A. Sec. 79z (b), in express terms declared the contracts void. It should follow that the operating companies are entitled to a refund, for no other result can fulfill the expressed purpose of the Act of protecting subsidiaries from the overreachings of holding companies. Thus, the statutory declaration of the necessity for control of holding companies in Sec. 1 (b) (2), 15 U.S.C.A. Sec. 79a (b) (2), states, inter alia, that the national public interest is adversely affected 'when subsidiary public utility companies are subjected to excessive charges for services'. The three specific sanctions stated in the Act—— injunction, Sec. 18 (f), 15 U.S.C.A. Sec. 79r (f); criminal punishment, Sec. 29, 15 U.S.C.A. Sec. 79z-3; and the negative relief of Sec. 26 (b), declaring the contracts void——do not in terms place the defrauded operating company in status quo; and Sec. 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies . . .

> . . . Furthermore, the analogy of the Securities Exchange Act is again useful. Private enforcement of Sec. 29 (b) of that statute has been permitted, *Geismar* v. *Bond & Goodwin, Inc.*, supra, while we have recently upheld broadly the private rights of action impliedly granted by the Securities Exchange Act, *Baird* v. *Franklin*, 2 Cir., 141 F.2d 238; and cf. *Charles Hughes & Co.* v. *S. E. C.*, 2 Cir., 139 F.2d 434, certiorari denied 64 S.Ct. 781. As we have pointed out in those cases, we think a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

The case did not involve asserted liability of the directors of Electric Bond & Share to it for causing it, through its controlled construction and service corporation, to enter into the void contracts with the power companies. Goldstein sought an accounting for "profits" made by the directors and the construction and service companies illegally contracting with the operating companies. Electric Bond & Share was a party because it acted through its controlled construction and service corporation. In other words, this was a suit for recovery of the consideration paid by the operating companies under the void contract. The Court carefully reserves the question of whether the recovery would be for the entire consideration or the excess thereof over the reasonable value of the services rendered. The case illustrates that jurisdiction implied under the void contract theory requires privity and does not hold that directors may be held liable to account to the corporation for return of a consideration which they did not receive.

Referring to *Geismar* v. *Bond & Goodwin, Inc.* supra, the Court there said:

> "A useful analogy in favor of this interpretation of implied liability can be found in Sec. 29 of the

Securities Exchange Act which is virtually identical with Sec. 26 of the Utility Act for it is now clear from the 1938 amendment to Sec. 29, 52 Stat. 1076 that Congress intended a right of recovery thereunder."

The section referred to is 15 U.S.C.A. 78cc (b) and the 1938 amendment is a provision added to the void contract section of the Exchange Act of 1934 reading:

> "Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of Section 78o of this title, and (b) that no contract, shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection by any person to or for whom any broker or dealer sells, or buying from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such violation is brought within the year after discovery and within three years after such violation."

Appellees argue that as the corporation acts through its officers and directors such parties in control must be held liable because if the company violates the acts they directly or indirectly cause the violation. They contend that the directors should be held liable under Section 80a-47 which provides:

> "(a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or other thereunder.

"(b) It shall be unlawful for any person without just cause to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, record, or account required to be made, filed, or kept under any provision of this subchapter and section 72 (a) and 107 (f) of Title 11 or any rule, regulation, or order thereunder. Aug. 22, 1940, c. 686, Title 1, section 48, 54 Stat. 846."

Section 80a-33 (b) provides:

"(a) It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any account, book or other document the preservation of which has been required pursuant to section 80a-30 (a) or 80a-31 (c) of this title.

"(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this subchapter and sections 72 (a) and 107 (f) of Title 11 or the keeping of which is required pursuant to section 80a-30 (a) of this title. It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document. Aug. 22, 1940, c. 686, Title 1, section 34, 54 Stat. 840."

Stadia Oil & Uranium Co. v. *Wheelis*, 251 F.2d 269 (10th Cir., 1957) is cited in support. There purchasers of se-

curities which were sold in violation of the 1933 Act sued one Rankin, a Vice-President and director of the corporation, among others and he denied participation. It was a jury question whether he was in "control" within the meaning of section 77a of the Act and under proper instructions the jury's verdict that he was in such control was sustained.

In *Hawkins* v. *Merrill Lynch et al.* 85 F.Supp. 104 (W.D.Ark. 1949) also cited to the same point. It was held that where the defendant was sued and held liable for sales of securities in violation of the Exchange Act of 1934 directed another in such a manner as to violate the rights secured by the legislation "there exists that degree of control necessary to create liability under section 78t (a)."

R. H. Johnson & Co. v. *Securities & Exchange Commission*, 198 F.2d 690 (2d Cir., 1952) also cited to the point. But we do not find that either of these three cases lend substantial support to appellees.

The Holding Company Act provision 79z-1 is the same as the Investment Act 80a-47. The Securities Act of 1933 has no comparable section. The Exchange Act of 1934 does have a comparable section 78t (b). Both the 1933 and 1934 Acts have sections making a person controlling any person who is liable under these Acts, jointly and severally liable with the controlled person (77o and 78t). The Investment Company Act has no such provision nor does the Holding Company Act. With respect to controlling persons the Investment Company Act indicates by its definition of "control" that the powers of control which inure to directors solely as the result of their official position in the company are not included in the word "control" used in respect to provisions in the Act. The definition reads:

> "'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

Appellants insist and we agree that this wording of the Act shows that it was the legislative intent to refrain from entering the field of director responsibility. There is a sense in which it can be said as appellees have argued that directors control the various corporate actions of management on policy, but by this provision directors acting in their official capacity are excluded from being held liable on that theory. As was stated in *Downing* v. *Howard*, 68 F.Supp. 6, 10, "At best, the alleged violations were violations by United. There is no provision in the Act imposing a duty or liability on officers or directors as such or upon outsiders acting in concert with officers and directors."

Appellees cite *Hooper* v. *Mountain States Securities Corporation*, ... F.2d ... (5th Cir., 1960) which was brought under the 1934 Act to recover on account of a fraudulent scheme concerted by defendants to have shares of stock issued for worthless property in order that the individuals could divide up the stock for their own use and get the benefits of their fraud. The court held the transactions to be within the purchase and sale provisions of the 1934 Act and the regulation. But on its facts the case does not have a bearing on the problem here in issue.

In *Taussig* v. *Wellington Fund, Inc.*, 187 F.Supp. 179 (D.C.Del. 1960) the controversy was between two investment companies both employing the name Wellington, which name was also used by the underwriters and advisors. The Court held the first investment company had the right to use the name Wellington and that use by the other was enjoined. Several provisions of the securities Acts were relied on to confer jurisdiction including

80a-34 (d) which makes it unlawful "for any unregistered investment company to adopt as a part of the name or title of such company any word or words which the Commission finds and by order declares to be deceptive or misleading". It appeared to the Court that as the federal claim was not frivolous or a sham the Fund had standing to prosecute the action but there was no need to rule substantively on the federal causes.

In *Aldred Mo. Trust* v. *Securities and Exchange Commission*, 151 F.2d 254 (1st Cir., 1945) the Commission sued under the Investment Company Act to enjoin the officers of an investment trust from continuing to act in such capacity and for the appointment of a receiver under 15 U.S.C.A. 80n-35 commonly referred to as the "gross abuse of trust" section. The case illustrates the instance in which the Act does deal with the matter of directors duty. It creates a right of action against directors to remove them from office for gross abuse of trust but it must be done on the initiative of the Commission. It furnishes no support for the liability of directors which Fund asserts on this appeal. In paragraph 1 and 2 on page 260, the Court refers to provisions of 15 U.S.C.A. Sec. 80a-1 (b) as effecting a codification of the fiduciary obligations imposed upon officers and directors of investment companies but the codification is of duties of the companies and the reference does not support a conclusion that Congress thereby created a federal cause of action in private individuals or by investment companies against their directors.

In *Cogan* v. *Johnson*, 162 F.Supp. 907 (S.D.N.Y. 1958) the plaintiff sueing individually and as a stockholder of an investment company which had been deregistered by the Securities and Exchange Commission charged a continuing conspiracy by the company and its officers and directors to violate the 1940 Investment Company Act and with

violations of the Act "in numerous ways". The relief sought was injunction against the continuing violations of the Act and injunction against the individual defendants preventing them from combining as officers and directors and for the appointment of a receiver to enable the company to comply with the Act. There was also a charge that the defendants caused the company to violate the Act for their own interests and were guilty of gross abuse of trust as officers and directors.

The District Court held that the individual stockholders had no standing to bring an action based on the gross abuse of trust section, 15 U.S.C.A. 80a-35. The Court declared however that it did not "appear to a certainty that the plaintiff is entitled to no relief under any state of facts which may be proved in support of his claim" and denied the motion to dismiss.

The appellants say in reference to the *Cogan* case that if the holding there is that directors are liable for the acts of their corporation in violation of the 1940 Act, it is wrongly decided and should not be followed by this Court.

Respecting *Schwartz* v. *Bowman*, 156 F.Supp. 361 (S.D.N.Y., 1957) and related cases of *Breswick & Co.* v. *United States*, 134 F.Supp. 133 (S.D.N.Y., 1955), and *Breswick & Co.* v. *Briggs*, 135 F.Supp. 397 (1955) the federal case in *Schwartz* was violation by the Alleghany Railroad of the Investment Company Act by acquiring the New York Central stock without registering under the Act. The Court on appeal said a joint venture or conspiracy to cause C. & O. and Alleghany to engage in a transaction prohibited by the Act was charged. Appellants stress the contention that "there is a fundamental and critical distinction to be drawn between a case where a director is an actor and joint tort feasor in violating a statute and a case where the asserted liability is predicated upon vicarious

liability for allegedly causing the corporation he serves to violate the statute". Because the Investment Company Act does not as do the 1933 and 1934 Acts create a joint duty and liability none can be implied to create a federal case. The conspiracy in the *Schwartz* and *Brunswick* cases distinguish them from the present appeal.

We do not find *Bell* v. *Hood*, 327 U.S. 678 (1945) to be relevant. The intent and effect of the decision as applied to the facts in that case were thoroughly considered by the District Court when the case was returned to it. 71 F.Supp. 813. The claim before the Supreme Court was that defendants had violated specified provisions of the federal law and Constitution. The doctrine of jurisdiction by implication where the federal statute has not imposed a duty was not discussed by the Supreme Court.

The District Court stated the rule it was required to follow, l. c. 820:

> "'Where, as here, neither the Constitutional provision nor any Act of Congress affords a remedy to any person, the mere assertion by a plaintiff that he is entitled to such a remedy' does not constitute a federal cause of action. . . .
>
> "In assuming jurisdiction under mandate of the Supreme Court, this Court is called upon to decide 'the issue of law . . . whether federal courts can grant money recovery for damages said to have been suffered as a result of federal officers violating the Fourth and Fifth Amendments.' . . .
>
> "Being of the opinion that neither the Constitution nor the statutes of the United States give rise to any cause of action in favor of the plaintiffs upon the facts alleged, I hold that federal courts cannot now grant such recovery. Nor does any other ground appear upon which relief can be granted to plaintiffs in this Court."

On consideration of the whole record and citations we conclude the claim stated against these appellants does not support the federal jurisdiction. At common law directors are liable to exercise due care and are not insurers. 13 Am. Jur. Corporation Sec. 990, p. 943-944. The complaints here substantially seek to hold these former directors to strict liability as insurers. The Act they rely on not only contains no such provision but plainly negates any intent to create such an innovation. The reliance upon implication to support the jurisdiction is not justified in the face of the legislative intent to exclude it.

In view of the conclusion that the motions for dismissal as to these appellants for lack of jurisdiction of the subject matter of the claim against them should be sustained, we need not discuss the question as to the out of the State service upon appellants, Rebstock and Rice.

Reversed with direction to dismiss the case as to these appellants.

A true copy.

Attest:

Robert C. Tucker,
Clerk, U. S. Court of Appeals, Eighth Circuit.

(Seal)

APPENDIX B.

(Judgment.)

United States Court of Appeals for the
Eighth Circuit.

No. 16,566—September Term, 1960.

J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice, Jacob Baker and George H. Shields, III,
Appellants,

vs.

Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company.

Appeal from the United States District Court for the Eastern District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Order of the said District Court overruling Motions to dismiss entered July 1, 1960, be, and the same is hereby, reversed with costs; and that J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock and Earl R. Rice have and recover against Managed Funds, Incorporated, a Corporation, Emanuel Josephson and Protective Casualty Insurance Company the sum of Two Hundred Forty and 65/100 ($240.65) Dollars for their costs in this behalf expended and have execution therefor.

And it is further Ordered by this Court that this cause be, and it is hereby, remanded to said District Court with direction to dismiss the case as to appellants, J. John Brouk, James J. Mullen, Jr., W. Munro Roberts, Jr., Jefferson J. Rebstock, Earl R. Rice, Jacob Baker and George H. Shields, III.

January 13, 1961.

APPENDIX C.

(Statute and Rule Involved.)

Sections 1 (b) (1), (2), (4), and (6), Sections 80a-1 (b) (1), (2), (4) and (6) of Title 15, U. S. C.:

"(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected—

"(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

"(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

"(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

"(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

. . . .

"It is declared that the policy and purposes of this subchapter and sections 72 (a) and 107 (f) of Title 11, in accordance with which the provisions of this subchapter and sections 72 (a), and 107 (f) of Title 11 shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors. Aug. 22, 1940, c. 686, Title I, § 1, 54 Stat. 789."

Section 9 (a), Section 80a-9 (a) of Title 15, U. S. C.:

"(a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company:"
(here follows a list of persons disqualified from serving.)

Section 10 (a), Section 80a-10 (a) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company."

Sections 15 (a) and (c), Sections 80a-15 (a) and (c) of Title 15, U. S. C.:

"(a) After one year from the effective date of this subchapter and sections 72 (a) and 107 (f) of Title 11 it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

"(1) precisely describes all compensation to be paid thereunder;

"(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

"(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

"(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser."

. . . . . .

"(c) In addition to the requirements of subsections (a) and (b) of this section it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any con-

tract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company."

Section 8 (b) (2), Section 80a-8 (b) (2), of Title 15, U. S. C.:

"(b) Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

. . . .

"(2) a recital of the policy of the registrant in respect of matters, not enumerated in paragraph (1) of this subsection, which the registrant deems matters of fundamental policy and elects to treat as such:"

Section 13 (a) (3), Section 80a-13 (a) (3) of Title 15, U. S. C.:

"(a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—

. . . . . .

"(3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 80a-8 (b) (2) of this title;"

Section 44, Section 80a-43 of Title 15, U. S. C.:

"The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter and sections 72 (a) and 107 (f) of Title 11, or the rules, regulations, or orders thereunder and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter and sections 72 (a) and 107 (f) of Title 11, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter and sections 72 (a) and 107 (f) of Title 11 or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or

wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28 and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia', approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter and sections 72 (a) and 107 (f) of Title 11 brought by or against the Commission in any court. Aug. 22, 1940, c. 686, Title I, § 44, 54 Stat. 844."

Section 47 (b), Section 80a-46 (b) of Title 15, U. S. C.:

"(b) Every contract made in violation of any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11 or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this subchapter and sections 72 (a) and 107 (f) of Title 11, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order. Aug. 22, 1940, c. 686, Title I, § 47, 54 Stat. 845."

Rule 8 (a) of the Federal Rules of Civil Procedure:

"(a) **Claims for Relief.** A pleading which sets forth a claim for relief, whether an original claim, counter-

claim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded."